MULTIMEDIA UNIVERSITY

STUDENT ID NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2016/2017

BFE2074 – FINANCIAL ECONOMICS

(All sections / Groups)

22 OCTOBER 2016
9.00 a.m. – 11.00 a.m.
(2 Hours)

INSTRUCTIONS TO STUDENTS

1. This question paper consists of THREE (3) pages with FOUR (4) questions only.

2. Attempt **ALL** questions. All questions carry equal marks and the distribution of the marks for each question is given.

3. Please write all your answers in the Answer Booklet provided.

Question 1

(a) (i) Explain the difference between foreign portfolio investment and foreign direct investment. (4 marks)

(ii) Explain why a nation might desire to receive both portfolio investment and direct investment from abroad. (2 marks)

(b) (i) Define foreign exchange arbitrage. (2 marks)

(ii) Suppose that in New York the euro and British pound trade at the following exchange rates: 1.121 \$/€ and 1.342 \$/£. In London, the euro equivalent rate of the pound is 1.278 €/£. Is there an arbitrage opportunity? Why or why not? Calculate the profit to be made on \$1,000,000. (10 marks)

(c) Using the information provided in the table below:

Year	Spot exchange
2014	2.42 RM/S\$
2016	2.98 RM/S\$

(i) Did Ringgit Malaysia appreciate or depreciate relative to the Singapore dollar? (2 marks)

(ii) What was the amount (in percentage-change terms) of appreciation/depreciation? (3 marks)

(iii) What was the impact of the exchange-rate change on Singapore consumers' purchasing power over Malaysian goods and services relative to their purchasing power over Singaporean goods and services? (2 marks)

[Total marks: 25 marks]

Question 2

(a) Name and explain THREE (3) types of foreign exchange risk exposure. (6 marks)

(b) Recently, Malaysia's current account deficit has increased tremendously which caused observers to question whether the nation can finance such deficit.

(i) Draw the diagrams for Malaysia's loanable funds market and the spot market for Ringgit Malaysia. (8 marks)

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(ii) Suppose that a general concern emerges about the nation's current account deficit that causes people to reallocate their savings away from Malaysia. Expand on your diagrams in (i) to illustrate and explain the likely impacts of such reallocation of savings on Malaysia's interest rates and on the exchange value of the RM. (4 marks)

(c) What are real interest rates, and how can real interest rate differentials serve as indicators of the extent to which international markets are open to arbitrage? (7 marks)

[Total marks: 25 marks]

Question 3

(a) Explain the following approaches to balance of payments and exchange-rate determination:

(i) Elasticities approach (3 marks)

(ii) Absorption approach (3 marks)

(iii) Monetary approach (3 marks)

(iv) Portfolio approach (3 marks)

(b) China is Malaysia's largest trading partner for the 7th consecutive year in 2015. Higher exports to China were registered for manufactured goods with an increase of 10.2 percent. Suppose Malaysia sells its manufactured goods on the international market in U.S. dollars at the international market price of $2.80 per Ringgit Malaysia. The exchange rate between the U.S. dollar ($) and the Ringgit Malaysia (RM) is 4.04RM/$, and the exchange rate between the Chinese Renminbi (RMB) and the U.S. dollar is 6.68RMB/$. Now suppose the Ringgit Malaysia depreciates by 6 percent relative to the U.S. dollar, but the exchange value between the Renminbi and the dollar remained constant.

(i) What is likely impact on the number of units of manufactured goods Malaysia export to China, assumes there is no exchange-rate pass through effect? (3 marks)

(ii) What is the likely impact on the value of Malaysia's exports in terms of the Renminbi? (4 marks)

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(iii) Suppose Malaysia's manufactured good exporters want to maintain their market share in China. How much should they adjust the dollar price of their exported manufactured goods? What is the new value of this export price in terms of the Renminbi? (6 marks)

[Total marks: 25 marks]

Question 4

(a) Explain the following schedules and the factors that determine their position:

(i) IS schedule (4 marks)

(ii) LM schedule (4 marks)

(iii) BP schedule (4 marks)

(b) The central bank of a small open economy with high capital mobility conducts unsterilized monetary policies. Explain the effects of a contractionary fiscal policy action with an appropriate diagram each if the country:

(i) maintains a fixed exchange rate. (6 marks)

(ii) adopts a flexible exchange rate. (7 marks)

[Total marks: 25 marks]

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